Appendix A

STATUTORY PROVISIONS.

Internal Revenue Code of 1939:

Sec. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealing in property, whether real or personal, growing out of ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Appendix B

United States Court of Appeals
For the Ninth Circuit

E. J. Murray, Petitioner, vs. Commissioner of Internal Revenue, Respondent.	No. 14,579 Mar. 30, 1956

On Petition to Review a Decision of the Tax Court of the United States

Before Stephens, Healy and Pope, Circuit Judges.

Pope, Circuit Judge.

This is a petition to review a decision of the Tax Court which approved the Commissioner's determination of a deficiency in income tax for the year 1947.[1] The opinion of the Tax Court is reported at 21 T.C. 1049 where the facts of the case are stated at greater length and in more detail than we find necessary here.

In 1928 the petitioner and his wife acquired certain real estate in Klamath Falls, Oregon. They borrowed $64,000 from a savings and loan association which they used to finance the construction of a building upon the property and secured the loan by a mort-

[1]Deficiencies were determined for both 1946 and 1947, but the 1946 deficiency is not in question here.

gage thereon. In 1932, when there was a balance due of $57,000 upon the mortgage debt, petitioner and his wife conveyed the building, subject to the mortgage, to a corporation whose sole stockholders were Wiley and D'Albini, petitioner's attorneys, and to the wives of Wiley and D'Albini. In 1934, the savings and loan association brought suit to foreclose its first mortgage and the property was sold pursuant to the foreclosure decree. On the last day of the statutory redemption period, the property was redeemed from the foreclosure sale by certain assignees of the Wiley-D'Albini corporation. In 1948 the petitioner and his wife brought suit in the Circuit Court of the State of Oregon against Wiley and D'Albini and their assignees and procured a sheriff's deed therefor, and after trial in that court and hearing upon appeal in the Supreme Court of Oregon, the latter court on June 30, 1942, upholding the contentions of the petitioner and his wife, held that petitioner's conveyance of the building to Wiley and D'Albini was made merely to secure petitioner's indebtedness to his attorneys; that their corporation held the property as mortgagee in possession, and that the conveyance to the assignees who redeemed from the mortgage foreclosure was also subject to petitioner's continued right to redeem the property, and that petitioner was beneficial owner of the property subject to the liens of the various defendants, all of whom stood in the position of mortgagees in possession.

The Oregon Supreme Court remanded the case to the Circuit Court for an appropriate accounting in

which defendants would be given credit for amounts paid to redeem the property, for the amounts paid to redeem from a federal tax lien, and for amounts owing for the legal services of Wiley and D'Albini, subject to certain named offsets. That court also ordered that upon payment of the amounts of these liens as ascertained by further accounting, the petitioner should be entitled to a reconveyance of the property, and in its decision (as revised on the petition for rehearing), the Oregon Supreme Court adjudged that the defendants should have credits in the ensuing accounting for their costs of management and repairs in the operation of the building while in possession thereof, and that the proceeding before the court was a suit by a mortgagor to redeem, not one to foreclose a mortgage. It was directed that unless petitioner did redeem the property from the liens the decree of the Circuit Court should determine and specify a reasonable time within which petitioner might redeem from the liens or be forever barred.

Upon the remand of the case to the Circuit Court, the accounting was taken as directed. A further appeal to the Supreme Court followed, but the action of the Circuit Court, with one minor exception, was affirmed on January 14, 1947. In the judgment thus affirmed it was ascertained that after charging petitioner with the amount of those liens and interest thereon, and crediting petitioner with the amount of the rents received by the so-called mortgagees in possession, and charging petitioner with the amount of expenses of maintenance, the amount required to

be paid by petitioner to redeem was $10,630.41. He paid that sum on February 28, 1947, and on that date a final decree was entered adjudging that he had satisfied all liens on the property, and the defendants were directed to reconvey to him within ten days or have the reconveyance occur through operation of the decree. Possession of the building was thereupon surrendered to petitioner.

Petitioner who is a cash basis taxpayer, had filed no income tax return for any of the years 1937 through 1945. He had no income during those years, but in July, 1947, he filed separate returns for all the years 1937 to 1946, reconstructing the income he would have had from his property in those years had he been in possession.

The Commissioner determined a deficiency in petitioner's income tax for the year 1947 based for the main part on the further determination that as a result of the transactions culminating in the final court decree above mentioned, petitioner had realized ordinary income of $57,512.64 in that year. This sum was arrived at as follows: In the Circuit Court accounting petitioner had been given credit and the defendants there had been charged with $102,589.45 received from rents on the building from 1936 to 1947. Interest had been added to this amount making the total credited to petitioner from this source $135,808.19. Against these credits there was charged maintenance expenses, interest on the mortgage, and other disbursements, totaling $78,295.55. The balance of $57,512.64 was the ordinary income thus charged to the petitioner by the Commissioner.

Petitioner contends that he did not realize any taxable income by reason of the state court litigation mentioned. He points out that he did not in the year 1947 or at any other time receive any cash or money as a result of the litigation and he asserts that the mere fact that the credits on account of the rentals received from the Murray Building were used to reduce the amount which he was required to pay to redeem the property from the liens against it, does not mean that this can be treated as income; that these liens were merely encumbrances on the property, and the amounts were not personal obligations of the petitioner.

Petitioner relies upon the case of Hilpert v. Commissioner, 5 Cir., 151 F. 2d 929, as authority for his assertion that the reduction, satisfaction or cancellation of an indebtedness or obligation which is not a personal obligation of the owner of property does not result in taxable income to him. The Tax Court, deeming the Hilpert case not controlling here, held that the net proceeds realized by the petitioner in the accounting proceeding were income to him; that the fact that the rents were realized only after great delay, did not change the character of the rent from a tax viewpoint. It sustained the position of the Commissioner that petitioner realized this ordinary income in the taxable year 1947 as a result of the termination of the litigation.

That the petitioner did realize ordinary income we think is clear. The economic benefit which petitioner realized and which grew out of the rents from the

building was within the rule recognized in Commissioner v. Smith, 324 U.S. 177, 181; Helvering v. Bruun, 309 U.S. 461, 469; and Helvering v. Horst, 311 U.S. 112, 115. It was stated in Commissioner v. Smith, supra, (which dealt with an employee's compensation), as follows: "Section 22(a) of the Revenue Code is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected."

We agree with the Tax Court that there is nothing in the Hilpert case which calls for a contrary conclusion.[2]

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[2]There Hilpert had given one Markell a deed absolute in form conveying rental property in Florida. In his tax return for that year (1931) Hilpert, following a ruling of the Collector, reported this as a sale for the amount he received, $65,000, and paid income taxes on a capital gain of $49,209.69. As a result of an action by Hilpert against Markell, the Florida courts held the transaction to be a mortgage instead of a sale, and held that Hilpert could redeem after an accounting of the rents. Hilpert made an arrangement with Lawton Investment Co., whereby he executed a deed to the latter placing it in escrow with an arrangement that if his suit to redeem was successful, the Lawton Investment Co., should have the right to redeem and acquire the property, in which case Hilpert was to receive $10,000 from Lawton plus half the difference between $65,000, the amount which the deed was given to secure, and any less sum which the court should decree as the amount required to be paid to redeem. After successful termination of the suit in 1940, Lawton redeemed the property and paid Hilpert $10,000 plus half the difference between $54,364.67, the amount fixed by decree as the redemption sum, and $65,000, together with some commissions agreed upon. Hilpert thus received $17,067.67, which he returned as his income from the transaction. (The sum of $54,364.67 decreed to be the redemption sum, was arrived at by crediting against the $65,000 mortgage paid, the sum of $10,635.33 of net rentals which Markell had collected.)

The effort of the Commissioner then to charge Hilpert with a capital gain measured by the difference between the sum of $54,364.67 and $10,635.33 and the basis, or March, 1913, value

This brings us to the second or alternate contention of the petitioner which is that assuming taxable income was realized as a result of the proceedings in the Oregon courts, the Tax Court erred in holding that all such income was realized in 1947. Petitioner's argument is that the state court litigation established the proposition that the mortgagees in possession of petitioner's property were in effect constructive trustees for petitioners at all times when they were receiving rents which, as the Oregon courts held, they were obliged to credit or apply for petitioner's benefit. Petitioner argues that hence they owed duties to him similar to those of an agent in possession of rental property. Said petitioner: If the receipts were in fact taxable income, they were taxable to the petitioner in the years of collection by the mortgagees in possession, just as collections made by a rental agent would be taxable to the principal in the years in which the agent received them. Petitioner argues therefore that at least as early as 1942, when the Oregon Supreme Court's first decision was rendered, this relationship between petitioner and the mortgagees in possession had become established. Hence the rentals received up to that time should have been taxable to petitioner in 1942, and the income thereafter received in the years 1942 to 1947 should have been taxable in those years as and when received by those constructive trustees.

of the property, was properly overturned. The rentals there aggregated only the $10,635.33. This was less than the amount Hilpert reported. The $17,067.67 was all he could possibly be said to have received. It is hard to imagine by what reasoning the Commissioner arrived at the claimed deficiency. The decision of the court of appeals was plainly correct, but we find nothing there which aids petitioner here.

We cannot accept this theory of the petitioner. The assessment and collection of taxes upon income presents practical problems which Congress has seen fit to deal with by the adoption of the annual accounting concept. As a practical matter had the Commissioner attempted to collect income taxes for the years 1937 to 1947, during which petitioner's rights and claims were in litigation, he would have confronted the impossibility of determining whether petitioner was or was not receiving income during that period, whether by way of economic benefits or otherwise and when the first judgment of the Oregon Supreme Court was handed down in 1942, the amount of such economic benefits was still uncertain.

While it is a hardship to petitioner to have all the income here dealt with returned as received in 1947, yet such appears to be the unavoidable consequence of this annual accounting concept.[3] As stated in Security Mills Company v. Comm'r., 321 U.S. 281, 286, (quoting in part from Burnet v. Sanford & Brooks Co., 282 U.S. 359): " 'All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.' The rationale of the system is this: 'It is the essence of any system of taxation that it should pro-

[3]Petitioner's hardship may well be that type which needs some legislative help, such, for instance, as that afforded by former Revenue Code § 107.

duce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation.' This legal principle has often been stated and applied. The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount." Cf. Dixie Pine Co. v. Commissioner, 320 U.S. 516, 519. Within that principle, the right of petitioner here to receive income by way of these economic benefits did not become final and definite in amount until 1947. That that was the first year in which the Commissioner could demand payment of tax is made plain by such cases as Northern American Oil v. Burnet, 286 U.S. 417, where the court said at page 423: "The net profits were not taxable to the company as income of 1916. For the company was not required in 1916 to report as income an amount which it might never receive. . . . There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the receiver pay over the money. Throughout 1916 it was uncertain who would be declared entitled to the profits. It was not until 1917, when the District Court entered a final decree vacating the receivership and dismissing the bill, that the company became entitled to receive the money. Nor is it material, for the pur-

poses of this case, whether the company's return was filed on the cash receipts and disbursements basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive." To the same effect see Seligman v. Commissioner, 7 cir. 207 F. 2d 489, 494,[4] and Lynch's Estate v. Comm'r., 2d cir., 150 F. 2d 747, 748.

What appears to us to furnish an unanswerable demonstration that the income was not received by the taxpayer until 1947 is the wording of the decisions of the Oregon Court. After petition for rehearing of its 1942 decision, that court supplemented its opinion by an express holding that the proceedings before the court was a suit by a mortgagor to redeem and not by a mortgagee to foreclose, and therefore the previous opinion would be modified to provide that unless petitioner did redeem the property from the liens, the decree of the circuit court should determine and specify a reasonable time within which petitioner might redeem from both liens or be forever barred. Upon the next appeal the Supreme Court affirmed the Circuit Court by opinion dated January 14, 1947, on all issues except that it directed that the decree be

[4]"Moreover, and more important, these cases, consistent with what we think is the universal rule, teach that realization of taxable gain must occur in the year during which it is sought to be taxed. This is so whether the realization comes from the receipt of cash, actual or constructive, or by the acquirement of property, and in the latter case the realization occurs 'when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him.' Horst, supra. In any event, realization of economic gain as a prerequisite to its taxability must be capable of ascertainment in extent or amount."

modified to provide that the defendants have a lien upon the mortgaged property in the amount of the ascertained balance but eliminating the personal judgment against petitioner. This was followed by the accounting which showed the balance required for redemption which, as previously stated, was $10,640.31. This amount was paid by petitioner to the clerk of the Oregon court on February 28, 1947.

It is apparent from the foregoing that the Oregon court took pains so to modify its decree as to make it clear that it was adjudging petitioner to have the right or privilege of redeeming but without any obligation on his part so to do or to pay any sum, he being given a reasonable time within which to redeem or be forever barred. All requirement of a judgment against petitioner was eliminated from the final decree. This makes it clear we think that until the accounting was completed on February 28, 1947, and petitioner paid the amount then for the first time ascertained, he was at liberty either to redeem the property and thus reap the fruits of his litigation, or, if the sum arrived at did not suit him, to walk away and leave the property without redemption. We apply here the general rule as stated in §42(a) of the Internal Revenue Code of 1939, which, as amended at the time here in question, was as follows: "The amount of all items of gross income shall be included in gross income for the taxable year in which received by the taxpayer unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period."

The Tax Court properly held that the income realized by petitioner through the Oregon litigation was received by him in the year 1947.

The judgment of the Tax Court is affirmed.

(Endorsed:) Opinion. Filed Mar. 30, 1956. Paul P. O'Brien, Clerk.

By reason of facts which came to his attention after the submission of this case, Judge Stephens deems himself disqualified and hence takes no part in its decision.

United States Court of Appeals
For the Ninth Circuit

E. J. Murray, Petitioner, vs. Commissioner of Internal Revenue, Respondent.	No. 14,579

JUDGMENT

Upon petition to review a decision of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the decision of the said Tax Court of the United States in this cause be, and hereby is, affirmed.

(Endorsed) Judgment
Filed and entered March 30, 1956,
Paul P. O'Brien, Clerk.

United States Court of Appeals
For the Ninth Circuit

Excerpt from Proceedings of Tuesday, May 15, 1956

Before: Healy and Pope, Circuit Judges.

ORDER DENYING PETITION FOR REHEARING

On consideration thereof, and by direction of the Court, It Is Ordered that the petition of petitioner, filed April 28, 1956, and within time allowed therefor by rule of court, for a rehearing of above cause be, and hereby is denied.

Appendix C

Circuit Court of Appeals, Fifth Circuit.

Hilpert et al. v. Commissioner of Internal Revenue.

No. 11,307

Nov. 20, 1945.

Petition for Review of Decisions of the Tax Court of the United States (District of Florida).

Proceedings on petition of Anna I. Hilpert and others to review a decision of the Tax Court of the United States, District of Florida, 4 T.C. 473, redetermining an income tax deficiency imposed by the Commissioner of Internal Revenue.

Devision reversed.

H. M. Voorhis, of Orlando, Fla., for petitioners.

Frederic G. Rita, Sewall Key, A. F. Prescott and Harold C. Wilkenfeld, Sp. Assts. to Atty. Gen., Samuel O. Clark, Jr., Asst. Atty. Gen., and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Sp. Atty., Bureau of Internal Revenue, both of Washington, D. C., for respondent.

Before Hutcheson, McCord, and Waller, Circuit Judges.

Waller, Circuit Judge.

Charles R. Hilpert and Minnie P. Hilpert are husband and wife, who, together with Anna I. Hilpert, were co-partners and prior to March 1, 1913, acquired some real estate in Orlando, Florida, the adjuster

value of which, for income tax purposes, was $15,668.25.

Prior to June 15, 1931, the Hilperts sought a loan from Frank E. Markell in the amount of $65,000, to be secured by a mortgage on the real estate. Markell did not want a mortgage but agreed to let the Hilperts have the $65,000 in exchange for a warranty deed, absolute in form, but with a side agreement to permit the Hilperts to buy the property back on or before June 15, 1933, for the price of $86,000 in cash. The deed was duly executed and delivered, as was the option to allow the Hilperts to repurchase.

On February 4, 1932, the accountant for the Hilperts wrote the Collector of Internal Revenue at Jacksonville, Florida, stating the facts as to the transaction and requesting a ruling as to how it should be reported in the 1931 tax return. The Collector replied by letter as follows:

"It is stated that taxpayers wished only to borrow $65,000 on the property, but the lenders insisted that the property be conveyed. You now wish to know whether this transaction will have to be returned in the income tax reports.

"It is the opinion of this office that this transaction can be described only as a definite sale of the property, and any profit represented from the sale shall be reported as income.

"The property has been conveyed by warranty deed and the taxpayers have no control over it except option to purchase it, which may or may not be exercised.

"It is entirely clear that any profit shown in the sales price of $65,000.00 is income to the sellers."

The Hilperts, following the instructions of the Collector, reported the transaction as a sale in the calendar year 1931 and paid income taxes on the resultant capital gain of $49,209.69.

When Markell received the deed he went promptly into possession, collected the rents, and made repairs at his own expense. The Hilperts failed to exercise the privilege of repurchasing the property on or before June 15, 1933, and Markell continued to treat the property as his own until January, 1940, when he, pursuant to the affirmance by the Supreme Court of Florida of a decree of the Circuit Court of Orange County, Florida,[1] reconveyed the property to assignees, or vendees, of the Hilperts.

The Circuit and Supreme Courts of Florida each held that the deed from the Hilperts to Markell, although absolute on its face, was given as security for money loaned and was, therefore, a mortgage. The Court did not order foreclosure of the mortgage, so declared, by the usual sale at public auction, but fixed a period of eighty-three days within which the plaintiffs would be allowed to redeem the property or else be barred of all right, title, and interest in the real estate involved.

The Court also took an accounting of the rents collected by Markell and his vendees, who were decreed to be in privity with him. After allowing Markell

[1]Markell v. Hilpert, 140 Fla. 842, 192 So. 392.

interest at six per cent on the $65,000, and after deducting the rents collected by Markell, the Court found that the amount necessary to redeem was $54,364.67. The net rentals collected by Markell paid the interest and reduced the $65,000, which he had paid the Hilperts, to the sum of $54,364.67.

On the 10th day of May, 1937, the Hilperts filed the suit against Markell and his vendees, asking the Court to decree the transaction to be a mortgage instead of a sale and to permit them to redeem after an accounting by Markell of the rents. On the same day the Hilperts placed, in escrow, in the First National Bank a deed to the real estate, with Lawton Investment Company as grantee. The escrow agreement set out, among other things: That the Hilperts were instituting a suit in the Circuit Court in and for Orange County, Florida, to redeem a mortgage evidenced by a deed from them to Frank E. Markell; that they had agreed to sell the property to Lawton Investment Company if the foregoing suit was successful; that the terms of the sale were the redemption price for the mortgage to be paid by Lawton Investment Company and $10,000 in cash to be paid to the Hilperts, plus one-half of the difference between $65,000 and any sum below $65,000 at which the decree of the Court should state the mortgage could be redeemed. The escrow agreement instructed the bank "* * * to deliver said deed to Lawton Investment Company, a corporation, any time up to ten days after favorable decree of Court becomes final, upon the payment to said bank of the sum of $10,000, plus one-

half the difference between $65,000 and any sum less than $65,000 decreed by the Circuit Court of Orange County, Florida, in the suit of Anna I. Hilpert, et al., versus Frank E. Markell, et al., to be the amount necessary to be paid to redeem the above mentioned mortgage; the amount collected to be turned over to parties of the first part upon their receipt. Should said deed be not taken up by Lawton Investment Company within ten days after favorable decree of Court becomes final, then said deed is to be returned to parties of the first part and this escrow shall cease and determine."

After the suit was terminated in favor of the Hilperts, Lawton Investment Company redeemed the property from the mortgage, paid Hilperts the sum of $17,067.67 made up as follows: $10,000, plus one-half of the difference between $54,364.67 and $65,000, to-wit, $5,317.67, and the further sum of $1750 as an agreed refund of commissions, and thereupon received the deed to the real estate from the Hillperts.[2] The Hilperts returned for income tax purposes the sum of $17,067.67, or the amount of cash that they

[2]The computation is as follows:

Original amount of mortgage	$65,000.00
Amount to redeem	54,364.67
Difference	$10,635.33
One-half of difference	5,317.67
Cash amount named in agreement for deed	$10,000.00
One-half of difference of mortgage and amount to redeem	5,317.67
Commission agreed upon by parties	1,750.00
Total	$17,067.67

had received as a result of the successful outcome of the suit. The contract with Lawton Investment Company was made in anticipation of, and wholly contingent upon, winning the suit.

In the transaction between them and Markell the Hilperts signed no note, or mortgage, or covenant of any kind whatsoever, evidencing any obligation to repay any sum of money. They executed only a deed purporting to convey the said real estate.

The Commissioner held that in addition to the $17,067.67 which the Hilperts had already returned for taxation they were also liable for $10,635.33 of net rentals collected by Markell which went to the reduction of the mortgage indebtedness, plus $54,-364.67, the amount paid by Lawton Investment Company to redeem, less, of course, the adjusted value of the property in March, 1913, of $15,668.25. The Tax Court sustained the Commissioner.

Although the Hilperts had acted on the advice of the Collector of Internal Revenue and treated the transaction as a sale in 1931 and had, for that tax year, paid on a capital gain of $49,209.69, no credit was allowed in the delinquency assessment by the Commissioner or by the Tax Court for the taxes so paid on the proceeds of the 1931 sale of the same property, even though the 1940 transaction is but an aftermath, or a winding-up, of the 1931 transaction.

The Tax Court said:

"It follows that when the petitioners in the tax year disposed of the property in what was an unmis-

takable sale, they did no more and no less than is done by any vendor when he sells property covered by a mortgage or other lien and receives in the purchase price cash or other property. The difference between his basis and the fair market value of the consideration received is taxable. Accordingly, petitioners are properly chargeable as capital gain with the difference between their basis and the consideration for the sale.

"There is no dispute as to basis. The controversy relates to the amount of the consideration. It is true that all that petitioners received upon the sale was the cash paid to them by the vendees. * * *".

"* * * Only when the facts are so peculiar that the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received can it safely be eliminated from the computation of gain."

We find no fault with the foregoing statement of legal principles but only in their application to the peculiar facts in this case. We think that the Tax Court erred in its view as to what the Hilperts received.

If the transaction between the Hilperts and Markell had created an enforceable liability against the Hilperts to repay $65,000 loaned by Markell, the discharge of that liability through the assumption and payment by a purchaser would unquestionably have been a benefit received, a consideration paid, and taxable as such. But in the present case the Hilperts signed no note, no mortgage, no covenant, and made no promise in writing, or otherwise, to repay the

loan. No action could have been maintained by Markell against the Hilperts.

Under Mortgages, 49 C.J., § 224, the general law is stated as follows:

"Absence of Covenant. If there is no such covenant in the mortgage and no collateral obligation in the way of a note, bond, or other evidence of the debt, an action of debt will not lie on the mortgage, but the property alone is charged with the lien and must be looked to by the mortgagee as the sole source out of which he is to make good his claim."

In 37 Amer. Jur., page 24, § 517, under Mortgages, there is this statement:

"Where there is no personal obligation and no personal covenant in the mortgage, the only remedy is against the property mortgaged."

In Hoskins v. Black, 190 Ky. 98, 226 S.W. 384, 385, the Court stated:

"It is generally held that an ordinary mortgage or deed of trust, which contains no covenant for the payment of the debt, is not evidence of indebtedness, and where there is no personal obligation and no personal covenant in the mortgage, the only remedy is against the property mortgaged. 19 R.C.L. 513. It is sufficient to establish a personal liability against the mortgagor, if the instrument contains admission of indebtedness on his part, in which event a promise will be implied and a legal liability created. However, to create a personal liability by implication, the admission of indebtedness contained in the instrument

must be sufficiently plain to show that such was the express understanding of the parties."

The fact that there was no covenant to repay the money, evidenced either by note, bond, mortgage, or other writing, would not prevent the enforcement of the mortgage against the mortgaged property even after the writing evidencing the debt had become barred by the statute of limitation. Ellis v. Fairbanks, 38 Fla. 257, 21 So. 107, 109.

The land was put up purely as a pledge under such circumstances that the Courts deem it to be a mortgage. Under the transaction petitioners had: (1) A right to repurchase within two years; (2) a right to have the contract construed as an instrument to secure the payment of money with the consequent right of redemption; and their failure to resort to either of these remedies would have eventually resulted in the loss of the land, but in no wise was there any personal liability which Markell could enforce against the Hilperts, and the only recourse that he had was against the realty.

In Florida no debt was created by the transaction but even if there had been, suit thereon would be barred unless brought within three years under § 4663 (5), C.G.L., F.S.A. § 95.11 (5), since there was no promise in writing to pay Markell. Even if there had been a note or a promise in writing, but not under seal, the statute of limitations would have run in five years (§ 4663 (3), C.G.L., F.S.A. § 95.11 (3). There surely was no obligation under seal and the statute of limitations had run against any suit on an

obligation not under seal long before 1940. The Florida Supreme Court held in Bank of Wildwood v. Kearl, 138 Fla. 527, 189 So. 866, that a deficiency decree cannot be made in foreclosure proceedings where the debt secured by the mortgage is barred by the statute of limitations.

That Court went further, in that case, and said that even though there was a covenant in a mortgage under seal providing that the mortgagor would pay sums made payable by virtue of the note secured by the mortgage, such a covenant in the mortgage was not sufficient to bind the mortgagor personally for the debt if the note itself was not under seal and was barred by the five-year statute of limitations. See also the more recent case of Alropa Corporation v. McNamee, 143 Fla. 785, 197 So. 514.[3]

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[3]In Alropa Corporation v. McNamee, supra (143 Fla. 785, 197 So. 515), the Supreme Court of Florida said:

"It will be observed that by the covenant relied upon the makers did not unconditionally promise 'to pay the debt evidenced by the note but the promise was to pay all and singular the principal and interest and other sums of money payable by virtue of the said promissory notes and this deed, or either.'

"This was not sufficient to constitute an unconditional independent covenant to pay the debt but was a covenant to pay such sums as might be required to be paid under the terms of the notes. In other words, this covenant was an agreement to be bound as far as the notes would bind the makers. Therefore, any defense applicable to the note would constitute a defense against the enforcement of this covenant. * * *

"In the case of Bank of Wildwood v. Kerl et al., 138 Fla. 527, 189 So. 866, we had under consideration a case in which the record showed that the notes given to secure the mortgage were barred by the statute of limitations and the covenant relied on contained in the mortgage was identical with the covenant involved in the present suit, and there we held:

"'A covenant within a mortgage under seal providing that mortgagor would pay sums payable by virtue of note secured by mortgage was not sufficient to bind mortgagor personally for

In 37 C.J. 704, § 23, it is stated:

"No deficiency judgment or decree can be made in foreclosure proceedings where the debt secured by the mortgage is barred by the statute of limitations."

There is nothing in the case to suggest that there was any personal liability of the Hilperts to Markell, and the record does not show that any effort was made in the State Court by Markell to assert, or to seek to enforce, any such liability. It further appears that even if a personal liability could be implied, the Florida three-year statute of limitations would have barred the right to recover before 1940. Markell no doubt realized that he had the right to proceed only against the security.

Since there was no note, no covenant, and no agreement to repay the $65,000, and no enforceable obligation against the Hilperts in the transaction, the Tax Court was wrong in holding that the payment of the $54,364.67 by Lawton Investment Company in redeeming the property was a benefit received by the sellers out of that purchase. The case clearly comes within the exception stated by the Tax Court that when the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received it is appropriate that the amount paid by another to redeem property from the mortgage should be eliminated from the computation of gain to the mortgagor.

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the debt; and hence if note, which was not under seal, was barred by five-year statute of limitations, a deficiency judgment could not be entered against mortgagor in foreclosure proceedings. Comp. Gen. Laws 1927, § 4663, subd. 3.'".

Since there was no personal liability that could accrue against the Hilperts, all that they got out of the transaction was the $17,067.67, and looking at the substance of the transaction rather than the form, it would seem that they sold only a right of redemption, or a right of action. Perhaps it might be accurate to say they sold a chose in action, or the right to have the fruits of a suit upon making certain payments in the event the suit was won, for it was the suit that produced the gain. The deed would have always been a deed if the suit had not resulted in its being declared a mortgage.

The taxpayers paid the taxes on $49,209.69 which they received out of this transaction in 1931 when the taxing authorities ruled that a sale had been made. The sellers received that sum but once, yet the effect of the decision of the Tax Court is to tax them twice on the same sum.

We agree with the dissenting opinion in the Tax Court that the Tax Court's holding seems to be entirely unrealistic. The appetite for taxes is not so voracious, the commands of the statute are not so inexorable, as to require the doing of an injustice when there is open another course that is more fully consonant with law and reason and which course, if followed, will lead neither to evasion by the taxpayer nor extortion by the Government.

Under these views the holding of the Tax Court that the petitioners are liable for the sum of $10,635.33, representing net rentals received by the mortgagee on the real estate and applied by the Court

as a credit on the mortgage, cannot be sustained. The obligation to redeem, under the contract with Lawton Investment Company, was not on the Hilperts, and the allowance of that sum by the Circuit Court of Orange County toward the reduction of principal and interest afforded no gain to petitioners in excess of the one-half of such amount which the Lawton Investment Company paid to petitioners and which petitioners returned and paid the taxes thereon. This one-half was included in the total of $17,067.67 paid by Lawton Investment Company to the Hilperts.

The judgment of the Tax Court is reversed.

HUTCHESON, Circuit Judge (dissenting in part and in part concurring).

In the letter[1] written by petitioners' counsel to the Collector, February 4, 1932, they stated that the transaction between them and Markell, in the form of a sale with an option to pay back, was in fact a loan. In their suit brought in 1937, and in the escrow agreement with Lawton made at the same time, they asserted that the transaction between plaintiffs and Markell constituted a loan of money to them with a mortgage to secure it, and not a sale. The district court so adjudged, and the Supreme Court affirmed. There was nothing in the petition, in the decree,

[1] "It is not the intent of the owner to sell this property at this price, but simply to borrow this amount of money, and following their preliminary negotiations for a loan they had made arrangements for using the money, and it would have embarrassed them greatly if the negotiations had fallen through. In consideration of this fact, they consented to the lender's method. * * * The Hilperts are expecting to take advantage of this option before it expires and do not feel that they should be taxed at this time simply for borrowing money."

or in the opinion of the Supreme Court indicating or even suggesting that the Hilperts were not obligated to repay the amount of the loan. Indeed, the decree required Markell to execute an instrument reciting in part, "and the said parties of the first part do fully acknowledge full payment of the indebtedness owning by parties of the second part". If, therefore, the lack of personal obligation, of which the majority opinion makes so much, were material here, and I think it wholly immaterial, in determining whether the property was sold to Markell in 1931, or, as the Tax Court held, to Lawton in January, 1940, the record, so far from showing that there was such lack of obligation, shows quite the contrary. But whether there was a personal obligation or lack of it, the record permits no escape from the conclusion that in fact and in law there was no sale in 1931, from which a capital gain could arise, but a loan, and that in fact and in law there was a sale in 1940, and a capital gain then arising. I think it clear, therefore, that the Tax Court was right for the reasons that it gave in sustaining the commissioner's determination as to the capital gains tax due, and the majority was wrong in reversing that determination.

On petitioners' second point, that they ought not to be taxed as ordinary income on $10,635, the difference between the $65,000 borrowed in 1931 and the $54,365 required to redeem in 1940, I agree with them. The Tax Court's assumption that this difference was received in 1940 as accumulated ordinary income then paid over is, I think, without basis in the record. If this amount were ordinary income received in that

year, certainly petitioner should be taxed on it. Certainly, too, there would be no inconsistency in doing this and also taking this amount into account in determining the amount they received under their contract with Lawton, and, therefore, their capital gain. It seems quite clear to me though that it is incorrect to say that this sum, the net remaining after offsetting receipts and disbursements for each of the years from 1931 to 1940, was a receipt of income in 1931. A decree entered on June 1, 1938, adjudicated (1) that the transaction was a loan and not a sale; (2) that petitioners were entitled to redeem; and (3) that the cause be referred to a master to ascertain and offset their disbursements from 1931 to 1938, inclusive, and determine the amount necessary to redeem. The master's report having come in, the final decree of August 20, 1938, adjudicated that, as a result of offsets of receipts and disbursements through the years, the amount then necessary to be paid to redeem the property was $59,360.16, or $5,639.84 less than the original debt. The decree affirmed, an accounting and offsetting for the years 1938, 1939 and to January 20, 1940, determined a further net reduction of $4,995.48. Of this amount less that $600 was received in 1940. The balance was the result of receipts and offsetting in 1938 and 1939. Thus, of the total of $10,635, which reduced the original loan of $65,000 to $54,364.67, only $600 was received in 1940. While, therefore, petitioners ought to have been taxed on this $600 as ordinary income received in 1940, I do not think they could have been taxed on the net receipts of other years. I, therefore, except as to $600, concur with the majority in reversing the Tax Court's judgment as to the $10,635.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and Regulations involved	2
Statement	2
Argument	5
Conclusion	10
Appendix	11–12

CITATIONS

Cases:

Arcadia Refining Co. v. *Commissioner*, 118 F. 2d 1010	6
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	6, 8
Commissioner v. *Smith*, 324 U. S. 177	7
Dixie Pine Co. v. *Commissioner*, 320 U. S. 516	7
Durkee v. *Commissioner*, 162 F. 2d 184	6
Healy v. *Commissioner*, 345 U. S. 278	7, 8
Helvering v. *Bruun*, 309 U. S. 461	7
Helvering v. *Horst*, 311 U. S. 112	7
Hilpert v. *Commissioner*, 4 T. C. 473	9
Hilpert v. *Commissioner*, 151 F. 2d 929	8
Hort v. *Commissioner*, 313 U. S. 28	6
Liebes, H., & Co. v. *Commissioner*, 90 F. 2d 932	6
Lynch's Estate v. *Commissioner*, 150 F. 2d 747	7
North American Oil v. *Burnet*, 286 U. S. 417	7
Old Colony Tr. Co. v. *Commissioner*, 279 U. S. 716	7
Raytheon Production Corp. v. *Commissioner*, 144 F. 2d 110, certiorari denied, 323 U. S. 779	6
Security Mills Co. v. *Commissioner*, 321 U. S. 281	8
Seligmann v. *Commissioner*, 207 F. 2d 489	7
Swastika Oil & Gas Co. v. *Commissioner*, 123 F. 2d 382, certiorari denied, 317 U. S. 639	6
Triplex Safety Glass Co. v. *Latchum*, 44 F. Supp. 436, affirmed, 131 F. 2d 1023	6
United States v. *Lewis*, 340 U. S. 590	7, 8
United States v. *Safety Car Heating Co.*, 297 U. S. 88	6

Statutes:
Internal Revenue Code of 1939:
Sec. 22 (a) (26 U. S. C. 1952 ed., Sec. 22 (a)) 6, 1
Sec. 42 (a) (26 U. S. C. 1952 ed., Sec. 42 (a)) 1
Miscellaneous:
Treasury Regulations 111:
Sec. 29.42–1 (a) 1
Sec. 29.42–2 1

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 312

E. J. MURRAY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 51–77) are reported at 21 T. C. 1049. The opinion of the Court of Appeals (R. 94–102) is reported at 232 F. 2d 742.

JURISDICTION

The judgment of the Court of Appeals was entered on March 30, 1956. (R. 103.) A petition for rehearing was denied on May 15, 1956. (R. 104.) The petition for a writ of certiorari was filed on August 11, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether, on the facts, the courts below correctly sustained the Commissioner's determination that the rental income in issue was realized by petitioner, a cash-basis taxpayer, in the year 1947.

STATUTES AND REGULATIONS INVOLVED

Sections 22 (a) and 42 (a) of the Internal Revenue Code of 1939, and Sections 29.42–1 (a) and 29.42–2 of Treasury Regulations 111 are set forth in the Appendix, *infra,* pp. 11–12.

STATEMENT

The facts are substantially undisputed and the findings of the courts below may be summarized as follows:

In 1928, E. J. Murray (the taxpayer) and his wife acquired certain real estate in Klamath Falls, Oregon. They borrowed $64,000 from a savings and loan association in order to finance the construction of a building upon the property, securing the loan by a mortgage on the premises. In 1932, when there was a balance due of $57,000 upon the mortgage debt, the taxpayer and his wife conveyed the building, subject to the mortgage, to a corporation whose sole stockholders were Wiley and D'Albini, the taxpayer's attorneys, and the wife of D'Albini. In 1934, the savings and loan association brought suit to foreclose its first mortgage and the property was sold pursuant to the foreclosure decree. On the last day of the statutory redemption period, the property was redeemed from the foreclosure sale by certain assignees of the

Wiley-D'Albini corporation. In 1938, the taxpayer and his wife brought suit in the Circuit Court of the State of Oregon against Wiley and D'Albini and their assignees. After trial in that court and hearing upon appeal in the Supreme Court of Oregon, the latter court, on June 30, 1942, sustained the contentions of the taxpayer and his wife. It held that the taxpayer's conveyance of the building to Wiley and D'Albini was made merely to secure the taxpayer's indebtedness to his attorneys; that their corporation held the property as mortgagee in possession; that the conveyance to the assignees who redeemed from the mortgage foreclosure was also subject to the taxpayer's continued right to redeem the property; and that the taxpayer was the beneficial owner of the property subject to the liens of the various defendants, all of whom stood in the position of mortgagees in possession. (R. 94–95.)

The Oregon Supreme Court remanded the case to the Circuit Court for an appropriate accounting in which the defendants would be given credit for amounts paid to redeem the property, for amounts paid to redeem from a federal tax lien, and for amounts owing for the legal services of Wiley and D'Albini, subject to certain named offsets. Its order stated that, upon satisfaction of the liens as ascertained by further accounting, the taxpayer would be entitled to a reconveyance of the property. In its decision (as revised on the petition for rehearing), the court also adjudged that the defendants should have credits in the ensuing accounting for their

costs of management and repairs in the operation of the building while in possession thereof, and that the proceeding before the court was a suit by a mortgagor to redeem, not one to foreclose a mortgage. It was directed that unless the taxpayer redeemed the property, the decree of the Circuit Court should specify a reasonable time within which he might do so or be forever barred. (R. 95.)

Upon remand, the accounting was taken as directed. A further appeal to the Supreme Court followed, but the action of the Circuit Court (with one minor exception) was affirmed on January 14, 1947. In the judgment thus affirmed, it was ascertained that after charging the taxpayer with the amount of the liens and interest thereon, crediting him with the amount of the rents received by the so-called mortgagees in possession, and charging him with the expenses of maintenance, the amount which he was required to pay in order to redeem was $10,630.41. He paid that sum on February 28, 1947. On that date, a final decree was entered adjudging that he had satisfied all liens on the property, and the defendants were directed to reconvey to him within ten days or have the reconveyance occur through operation of the decree. Possession of the building was thereupon surrendered to him. (R. 95–96.)

The taxpayer, who was on a cash basis, had filed no income tax returns for any of the years 1937 through 1945. He had no income during those years, but in July, 1947, he filed separate returns for the years 1937–1946 inclusive, reconstructing the income he

would have had from his property in those years had he been in possession. (R. 96.)

The Commissioner determined a deficiency in income tax for the year 1947 based, for the main part, on his finding that, as a result of the transactions culminating in the final court decree above mentioned, the taxpayer had realized ordinary income of $57,512.64 in that year. This sum was arrived at as follows: In the Circuit Court accounting, the taxpayer had been given credit for (and the defendants there had been charged with) $102,589.45 received from rents on the building from 1936 to 1947. Interest had been added to this amount, making the total credited to the taxpayer from this source $135,808.19. Maintenance expenses, interest on the mortgage, and other disbursements, totaling $78,295.55, had been charged against these credits. The balance of $57,512.64 was the ordinary income thus charged to the taxpayer by the Commissioner. The Tax Court and the Court of Appeals sustained the Commissioner's determination. (R. 96, 69–74, 102.)

ARGUMENT

1. The court below, affirming the Tax Court, held that the taxpayer realized income in 1947 when, as a result of the final accounting made and the decree entered in that year in the state court litigation, he received an amount which represented in effect, the net rentals and interest derived from the property. The decision is correct and embodies well established principles of law. In arriving at the balance of $10,630.41 which the state court required the taxpayer to pay the

mortgagees in possession as a condition precedent to redemption of the property, the taxpayer was given credit for $57,512.64, which represented net rentals collected by the mortgagees during the period 1936 to 1947, inclusive, plus interest. The entire transaction was properly regarded as if the taxpayer had recovered a judgment for $57,512.64 representing the net rentals collected by the mortgagees in possession.[1] See *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932, 935 (C. A. 9th); *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110, 113 (C. A. 1st), certiorari denied, 323 U. S. 779; *Triplex Safety Glass Co.* v. *Latchum*, 44 F. Supp. 436 (Del.), affirmed, 131 F. 2d 1023 (C. A. 3d); *Arcadia Refining Co.* v. *Commissioner*, 118 F. 2d 1010, 1011 (C. A. 5th); *Swastika Oil & Gas Co.* v. *Commissioner*, 123 F. 2d 382 (C. A. 6th), certiorari denied, 317 U. S. 639; *Durkee* v. *Commissioner*, 162 F. 2d 184 (C. A. 6th); *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363–364; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93–94; *Hort* v. *Commissioner*, 313 U. S. 28, 30–31. The fact that the taxpayer received no cash is immaterial. "Section 22 (a) of the Revenue Act is broad enough to include in taxable income any economic or financial benefit * * *, whatever the form or mode by which

[1] The Tax Court stated the point as follows (R. 71): "There would be no doubt that, had he been in possession during this period, and had actually received the rents, he would have been required to return them as ordinary income—offset, of course, by permissible deductions. The fact that the rents were realized only after great delay and then through the medium of a judicially ordered accounting proceeding does not change the character of rent from a tax viewpoint."

it is effected." *Commissioner* v. *Smith*, 324 U. S. 177, 181. See also *Helvering* v. *Bruun*, 309 U. S. 461, 469; *Helvering* v. *Horst*, 311 U. S. 112, 115; *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 729.

The entire amount of the $57,512.64 was properly allocated to 1947, for it was not until that year that the taxpayer's disputed right to receive any rentals, and the amount thereof, became fixed and certain. Cf. *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516, 519. See also *North American Oil* v. *Burnet*, 286 U. S. 417, 423; *United States* v. *Lewis*, 340 U. S. 590; *Healy* v. *Commissioner*, 345 U. S. 278; *Seligmann* v. *Commissioner*, 207 F. 2d 489, 494 (C. A. 7th); *Lynch's Estate* v. *Commissioner*, 150 F. 2d 747 (C. A. 2d). Until the accounting proceeding was actually terminated, there was no definitive apportionment of the income from the property between the taxpayer and the mortgagees in possession. Nor was it at all certain that the taxpayer was entitled to any rents until he voluntarily complied with the provisions of the final decree, a conclusion which the Court of Appeals considered unanswerably demonstrated by the fact that (R. 101):

> * * * he was at liberty either to redeem the property and thus reap the fruits of his litigation, or, if the sum arrived at did not suit him, to walk away and leave the property without redemption.

In the circumstances, the conclusion that the $57,512.64 constituted the taxpayer's income in 1947 was, as the Court of Appeals held (R. 99), "the unavoidable con-

sequence of * * * [the] annual accounting concept" of reporting income. *Healy* v. *Commissioner, supra,* p. 281; *United States* v. *Lewis, supra,* p. 592; *Burnet* v. *Sanford & Brooks Co., supra; Security Mills Co.* v. *Commissioner,* 321 U. S. 281, 286.

2. There is no direct conflict between *Hilpert* v. *Commissioner,* 151 F. 2d 929 (C. A. 5th), and the decision below. In the *Hilpert* case, the taxpayers conveyed property in 1931 by a deed absolute in form. They reported the amount paid them on a capital gain basis, and paid a tax thereon. Subsequently, as the result of the taxpayers' action, the Florida courts held that the original transaction was a mortgage, not a sale, and that the taxpayers could redeem after an accounting of the rents. The taxpayers transferred their right to redeem to a third party. After successful termination of the litigation in 1940, the third party redeemed the property, and paid the taxpayers an amount determined by a formula which had been agreed upon between them. In substance, the taxpayers returned that amount as income on a capital gain basis, and paid tax thereon. One of the consituent elements of the formula was the amount which had been fixed by court decree as the redemption sum. The sum, in turn, had been arrived at by crediting the taxpayer with the net rentals collected by the mortgagee, as an offset against the amount of the mortgage indebtedness. Although the Court of Appeals did hold that the amount credited as net rentals did not constitute income to the taxpayers, it was careful to note (p. 933) that the case primarily involved the sale of a right of redemption, and that

the taxpayers had reported and paid taxes on an amount exceeding the net rentals for which they had been given credit.

Judge Arundell, who had agreed with the dissenting opinion in *Hilpert* (4 T. C. 473, 477–478), which was subsequently approved by the Court of Appeals for the Fifth Circuit, stated, in deciding the instant case in favor of the Commissioner (R. 72–73):

> The facts which influenced the Court of Appeals in the *Hilpert* case are absent in the instant proceedings and we do not think that that decision should be regarded as at all binding on us.

He noted that the taxpayers in *Hilpert* had treated the original transfer of property as a sale and had paid a tax on that transaction; that they had also sold the property, after successfully contending before the Florida courts that the original transfer was a mortgage, and had paid another tax on that transaction; and that the Fifth Circuit, accordingly, had observed that the practical effect of the Tax Court's decision was double taxation.

The Court of Appeals agreed (R. 97) "that there is nothing in the *Hilpert* case which calls for a contrary conclusion" here. It noted that the taxpayers there had reported more than the net rentals offset against the claim of the mortgagees in possession, and that, although the (R. 98) "decision of the court of appeals was plainly correct, * * * we find nothing there which aids petitioner here."

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.42-1. *When Included in Gross Income.*—(a) *In general.*—Except as otherwise

provided in section 42, gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * * If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in the later year, assuming that the money or property would have been income in the earlier year if then received. * * *

* * * * *

Sec. 29.42–2. *Income Not Reduced to Possession.*—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. * * *

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